

VZCZCXRO9168  
RR RUEHLMC  
DE RUEHSN #2385/01 3451924  
ZNR UUUUU ZZH  
R 111924Z DEC 07  
FM AMEMBASSY SAN SALVADOR  
TO RUEHC/SECSTATE WASHDC 8708  
RUCPDO/USDOC WASHDC  
RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC  
RUEHRC/USDA FAS WASHDC

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STATE ALSO PASS USTR  
USDOC FOR 4332/ITA/MAC/WH/MSIEGELMAN  
3134/ITA/USFCS/OIO/WH/PKESHISHIAN/BARTHUR  
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E.O. 12958: N/A

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SUBJECT: NEW SERVICES LAW PROVIDES INVESTMENT INCENTIVES

#### Summary

1. El Salvador's International Services Law, approved on October 11, will regulate the establishment and operations of service parks and centers with incentives similar to those received by El Salvador's free trade zones. Developers and administrators will receive tax breaks, while service companies will receive permanent tax and tariff exemptions. End summary.

#### Overview

2. The Legislative Assembly approved on October 11, the International Services Law, a project presented by President Saca last June to mark his third anniversary in office (reftel). The aim of the law is to develop services centers and parks. In these service zones, service firms will receive incentives similar to those received by firms in the free trade zones. The law regulates the operation of services parks and centers, as well as the benefits and responsibilities of service firms that benefit from the law. In order to benefit from the law, a service must be exported.

3. The idea of promoting services is not new and goes back to the beginning of the Saca's Presidency, when Uruguayan consultant Juan Opertti performed a study about El Salvador's economic future in services in order to offset the expected devastating loss of jobs in the maquila sector due to Chinese competition. At the end of 2004, the government announced a plan to retool and promote the country as the regional distribution center for Central America. One of the advantages of the law is that it does not contradict the WTO in the General Agreement on Trade in Services (GATS), since GATS does not forbid subsidies for the export of services. (Note. Earlier this year, the WTO extended the deadline from 2009 to 2015 for El Salvador to eliminate its WTO non-compliant free trade zones. End note.)

#### Definition of Services Parks and Centers

4. The law defines a service park as an area without resident population with the capacity to establish and operate several services companies. A service center is an area limited to one company. The Ministry of Economy will be in charge of classifying an area as a service park or service center. Additionally, in order to operate, a service park will need a Ministry of Economy certified administrator.

#### Fiscal Incentives Granted by the Law

5. Service parks developers will be exempted from the payment of the

income tax for 15 years, municipal taxes over the company assets for 10 years, and real estate transfer taxes. Service parks administrators will be exempted from the payment of the income tax for 15 years and from the payment municipal taxes over the company assets for 10 years. The service companies or firms declared as service centers will have the following permanent benefits: tariffs exemption for the import of capital goods, machinery, equipment, tools, supplies, accessories, furniture and other goods needed for the development of the services activity (other goods and services such as foods and beverages, tobacco products, alcoholic beverages, rental fees, home equipment and furniture, cleaning articles, luxury goods, transportation vehicles, and hotel services are not exempted from taxation); exemption from the payment of income tax and municipal taxes over the company assets. The tax exemptions remain in place as long as the service operations are functioning. Service firms operating under the existing Free Zones law are also covered. However, if the services are provided to the national market, they cannot receive the benefits of the Services Law.

#### Services Covered

##### ¶6. Services covered by the law include:

- International Distribution
- Logistical International Operations
- Call Centers
- Information Technology
- Research and Development
- Marine Vessels Repair and Maintenance
- Aircraft Repair and Maintenance
- Entrepreneurial Processes (i.e., business process outsourcing)
- Hospital-Medical Services
- International Financial Services

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¶7. Several other services can be installed in the service parks without receiving the benefits of the law. These services include hotels, airlines, electricity, communications and telecommunications services (except call centers and telephone firms that do not have their own fixed networks and are used for international communication), banking, financial and insurance services (with the exception of those specifically included in the law), air, sea and land transportation, tourism and courier services, and other technical and professional services such as legal, tax, construction, publicity, and other consultants.

#### Minimum Investment Requirements

¶8. Beneficiaries must invest at least \$150,000 during the first year of operations, including working capital and fixed assets. They must also hire no less than ten permanent workers and have at least a one year contract. For hospital/medical services, the minimum investment in fixed assets must be \$10 million if they are to provide surgical services or a minimum of \$3 million if they do not provide surgical services. Hospital or medical services must be located outside of major metropolitan areas. The service must also be provided only to patients that are insured with national or foreign insurance companies.

¶9. According to press accounts, the private sector, as represented by the private Business National Association (ANEP), the Salvadoran Logistics Chamber, and the Free Zones Association were very pleased with the approval of the new legislation. They indicated, however, that other changes are needed in order to fully take advantage of the law, including more bilingual education, more educated technicians, and more infrastructure investments such as the airport expansion, the Port of "La Union" (scheduled for completion at the end of 2008), and the Millennium Challenge Corporation (MCC) financed highway in the northern part of the country.

#### Comment

¶10. The new law should help to attract investment in the services sector. One U.S. health care provider has already inquired about providing medical services in the country. The law is also part of the Government's efforts to make El Salvador a regional logistics and distribution center. According to one government estimate, if the country captures 5 percent of regional transit, it could generate 32,000 new jobs. Private sector job creation and economic diversification will not only help El Salvador in the long run, it will help the ruling party's (ARENA) chances for re-election in ¶2009. However, they also must improve the security environment and have a WTO acceptable plan for the elimination of the free trade zones sooner rather than later, if they hope to reach those goals.

Glazer